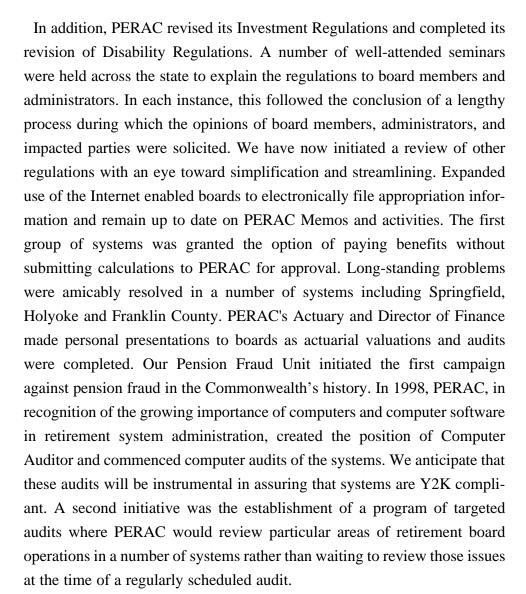
STATEMENT FROM THE ACTING EXECUTIVE DIRECTOR

uring 1998 the Massachusetts pension community adjusted to some new realities while confronting the possibility of dramatic change. The transfer of cost of living adjustment (COLA) decision making and financing from the state to the local governmental units was accomplished, in most instances, with little discomfort, as we indicated in last year's report. As the Public Employee Retirement Administration Commission's (PERAC) Report to the Legislature on the Impact of Chapter 17 concluded, recent progress in the funding of overall liabilities enabled the systems to include COLAs in modified funding schedules without creating an undue financial burden for a majority of systems.

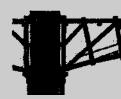
However, as boards rose to meet that challenge, the specter of mandatory Social Security coverage for public employees threatened the very foundation of the Massachusetts pension system. To combat the new threat, the Commission worked closely with the Massachusetts Teachers' Retirement Board to develop a coalition comprised of the retirement community, represented by the Massachusetts Association of Contributory Retirement Systems; retirees, represented by the Retired State, County, and Municipal Employees Association of Massachusetts; and a broad representation of organized labor and the employer community, represented by the Massachusetts Municipal Association.

A major victory occurred in 1998 as efforts spearheaded by PERAC removed the responsibility for the Early Intervention Programs created under Chapter 306 from the retirement boards. PERAC also worked intensely with the Ethics Commission as it developed an opinion concluding that board member participation in a decision to grant a COLA did not raise conflict issues under Chapter 268A. In addition, PERAC worked with the Department of Revenue (DOR), to insure an orderly implementation of the new law relating to attachment of retirement accounts to satisfy child support orders. In particular, we were pleased that DOR adopted our suggestions regarding a pilot project as well as other recommendations emphasizing the unique aspects of retirement system administration. Finally, our expanded efforts to assist the Legislature in its deliberations regarding retirement proposals insured that the retirement board perspective would be considered.



All of these actions are consistent with the course set by the Commission upon its taking office. PERAC is committed to resolving problems, reaching out to boards, and fulfilling its statutory obligations. At the present time, we are finalizing the protocols for the acceptance by PERAC of actuarial valuations and audits conducted by private firms retained by the boards in lieu of PERAC completing those audits and valuations. This will result in more frequent audits and valuations and the development of an important relationship between boards and their service providers. It is the Commission's view that an annual actuarial valuation, as well as an annual audit, are responsible actions that protect the interests of system members and beneficiaries. This new procedure should facilitate the completion of annual valuations and audits.

One of the major initiatives PERAC has undertaken is the creation of a comprehensive and easy to access Home Page on the Internet. We take great pride in the creation of this page and urge boards and other parties to avail



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themselves of the resources available on the PERAC Home Page. These include all PERAC regulations, a Commission and retirement board directory, retirement board profiles, PERAC publications (including updates, annual reports, studies, and retirement guides), a form for the direct submission of legal questions, PERAC bulletins, PERAC unit materials and Commission policies, PERAC memos for 1997, 1998, and 1999, PERAC forms, and job openings at retirement boards and at PERAC. Access to the PERAC Home Page can ensure that boards and administrators remain up-to-date and fully informed.

Turning our attention to the financial market environment, in 1998 we find that the US economy once again turned in a performance that was the envy of the rest of the world. The wave of economic and financial turmoil that began in Asia in 1997 affected Russia and then Latin America during the year, but the US continued to enjoy healthy growth with low inflation. Our trade deficit widened as troubles abroad slowed demand for our exports and boosted demand for imported goods. Nevertheless, our economy was boosted by strong consumer spending, encouraged by low unemployment, higher wages, and the "wealth effect" of a soaring stock market.

The optimism that kept shopping malls and auto showrooms busy carried over to the financial markets in 1998. The stock market recovered fully from a sharp mid-summer decline and the Standard & Poor's 500 Index of large capitalization stocks returned in excess of 20% for an unprecedented fourth straight year. However, returns were far from uniform. While many high-flying technology and Internet stocks returned much more than the S&P 500's 28.6% return, most stocks actually returned far less. Size of market capitalization was a primary determinant of performance; the 50 largest stocks in the S&P 500 earned more than 40% while the other 450 returned less than 17%. Small cap stocks, as represented by the Russell 2000, actually declined 2.5% for the year. Another huge disparity was that growth stocks within the S&P rose 42.2% while value stocks rose 14.7%.

Returns varied widely among overseas stock markets, with big gains in Europe, small gains in Asia, and losses in most emerging markets. Overall, developed international markets, as measured by the Morgan Stanley Europe Australasia & Far East (EAFE) Index, returned 20.3%

Bonds also enjoyed positive performance in 1998 and, as with stocks, the returns were widely dispersed. With consumer prices rising at a rate of less than 2%, the Federal Reserve was able to cut short-term rates three times even though economic growth remained strong. US Treasury securities, benefiting from a "flight to quality" among investors as well as reduced

supply arising from the government's lower financing needs, enjoyed the best performance as long term rates fell by about 1% to just above 5% at year-end. Investment grade corporate bonds and mortgage-backed securities did not do nearly as well, and high-yield "junk" bonds generally declined in price. Overall, the Lehman Brothers Aggregate Bond Index of Treasuries and investment grade securities returned 8.7% for the year.

Massachusetts' pension systems once again enjoyed the benefits of positive overall market trends. Statewide, the systems achieved a 1998 return of 15.64%. In the 1994–1999 period the funds returned 13.99% and since 1985, investment performance has been 12.42% on an annualized basis.

These returns contributed to the improved financial status of many systems as reflected in the funded ratios outlined in this *Annual Report*. This is the second year PERAC has included actuarial information designed to underscore the link between investment activity and financial condition. We have also incorporated audit findings in profiles of each system to provide a more complete picture of the condition of retirement systems.

The Commission wishes to commend the staff for developing this *Annual Report* and for their dedication to the mission and many responsibilities so well executed throughout the past year.

Finally, on behalf of both the Commission members and the staff, I want to acknowledge the efforts, dedication, and commitment of former Executive Director Robert F. Stalnaker whose professionalism and foresight during his tenure is mirrored in this *Annual Report* as well as in the ongoing activities of PERAC.

Joseph E. Connarton

Acting Executive Director

Poseph E. Connactors



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